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IRON AGE
METALS PRODUCER
DECEMBER 5, 1986

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Are Banks the Villains in World Steel Glut?

DECEMBER 5, 1986 VOL. 229, NO. 23

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Cover Photo: Courtesy of Weirton Steel Corp.

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IRON AGE (USPS 269-780) is published 24 times a year by CHILTON COMPANY, Chilton Way, Radnor, PA 19089. Chilton Co. is a division of American Broadcasting Companies, Inc., New York, N.Y. Second Class Postage Paid at Wayne, PA 19087 and additional mailing offices. IRON AGE is sent on a controlled free basis to qualified managers in U.S. metalworking companies. All others: Manufacturing Management edition – $52 one year, $85 Canada/Foreign (24 issues). Metalsproducer edition – $30 one year, $56 Canada/Foreign (12 issues). Single copies, $3.00. Cable Chilton Philadelphia.
Send address changes to IRON AGE, P.O. Box 3026, Wheaton, IL, 60189.

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The study was done on 1985 data by the American Iron and Steel Institute (AISI) with technical help from the U.S. Commerce Department and the Bethlehem Steel Corp. Its main finding: the "indirect steel trade" in 1985 resulted in imports of products containing 16.1 million net tons of steel, and exports of products with 8.7 million net tons. That comes to what AISI calls a "U.S. indirect steel trade deficit" of 7.4 million tons.

The study's other findings include:

—That those 7.4 million tons of steel—over and above the 22.3 million tons of direct finished steel mill product imports—were supplied by foreign steel mills for manufactured products sold in the U.S. in 1985. And, the two sources combined accounted for about 30 pct of all domestic steel demand last year.

—Motor vehicles and parts accounted for two-thirds of the net indirect steel deficit.

—In terms of country of origin, Japan was the largest supplier of steel-containing imports with 36 pct of the total. Canada and the European Economic Community were next in line with 24 and 23 pct, respectively. And, within the EEC, West Germany was the largest supplier of imports with 53 pct of its total.

In releasing the study, AISI contended in a statement, "The data confirm the growing problem of 'hollow corporations' operating in the U.S. As a result, neither the basic steel industry nor many of its major customers have been able to participate in the nation's economic recovery over the past four years."

The trade group also said the study "calls into question" the extent of the decline in domestic steel demand, adding, "The fact is, that if you add the 7.4 million tons of steel consumed directly in the U.S. in 1985 to the 'apparent supply' of steel mill products consumed in the U.S. last year—94.4 million tons—you find a total of about 102 million tons of steel (direct and indirect combined) moving into consuming channels."

It added, "That is about 20 million tons below the boom years of 1973-74, but is not far from the level achieved in 1981—the last good year the steel industry had."

AISI then claimed, "What these figures... substantiate, is that, while steel demand has been hurt by the substitution of competitive materials and the downsizing of automobiles, there has not been a drastic shift away from goods made of steel. Rather, it is soaring imports of steel—both direct and indirect—that primarily account for reduced steel demand from domestic mills."

Wheeling-Pittsburgh posts a $19 million profit in third quarter

For the third quarter of 1986, Wheeling-Pittsburgh Steel Corp. reported a net income of more than $19 million.

That came to 8.4 pct of sales, which was the best for any large steel company in the quarter. It was the best for any steel company in years.

Wheeling-Pittsburgh is bankrupt, of course, and that condition reduced interest expense by $12.4 million in the third quarter. The financial failure also relieved the company of some pension obligations and helped in reducing labor costs to $18 an hour.

More recently, LTV Corp. joined Wheeling-Pittsburgh in bankruptcy. LTV is seeking to renegotiate its labor contract with United Steelworkers of America. The company may have to turn over part of its pension burden to the government.

There have been steel bankruptcies in the past. McLouth Steel and Alan Wood are just two of the casualties. But the LTV and Wheeling-Pittsburgh failures are massive and affect the sheet grades that are the basis for tonnage production.

Other mills wonder about the multi-tier cost structure being created by the bankruptcies.

"Two of our major competitors have filed for chapter 11 bankruptcy protection," said Robert L. Loughhead, president of Weirton Steel Corp. "While operating under protection from creditors, they are achieving many cost eliminations or avoidances that are inherent, at least temporarily, in Chapter 11."

Weirton has been able to prosper in this environment. The company earned over $11 million in the third quarter. Mr. Loughhead noted that Weirton, itself, was a "reconstituted" steel company. In this case, the cost reduction was achieved by the willingness of employees to take a pay cut.

You have to wonder if the whole industry isn't heading toward some common denominator. With a significant portion of the industry bankrupt, it may be difficult for any large mill to stay solvent.

The work stoppage at steel plants of USX Corp. will probably postpone the industry's day of reckoning, but third quarter results suggested that a showdown would be coming. Losses were sustained by USX, Bethlehem, Armco, National and Inland in the quarter.

Steel's Third Quarter
(In Millions of Dollars)

	Earnings	Sales
USX	(163.00)	3,343.00
BETHLEHEM	(71.30)	1,032.90
INLAND	(4.65)	785.74
ARMCO	(59.00)	633.20
NATIONAL	(18.60)	531.30
CYCLOPS	1.80	344.21
WEIRTON	11.12	295.14
WHEEL-PGH.	19.17	228.75
NUCOR	13.91	195.74
CARPENTER	1.15	117.37
LUKENS	1.77	101.88
FLORIDA	5.78	87.07
COPPERWELD	(1.36)	79.93
QUANEX	(3.73)	75.60
LACLEDE	1.11	60.25
CF&I	(11.66)	42.06
EASTMET	(3.77)	19.85

() denotes a loss

ARE BANKS THE VILLAINS IN WORLD STEEL GLUT?

After providing the funds for a massive expansion in the late 1970s, steelmakers in the developing nations contend, the bankers then pulled the plug by jacking up interest rates.

BY GEORGE MCMANUS

For the world's steel producers, money is the root of many evils.

Overcapacity, unfair trade, and other evils can be traced in part to the monetary sequence that began in the 1970s with the explosion of oil prices. Gushing oil dollars flowed into banks and were recycled into developing countries.

"Mexico's foreign debt grew from $35 billion in 1978 to $88 billion in 1982," said Rafael R. Paez, chairman of Grupo Industrial Alfa, which owns Hylsa.

Mr. Paez took part in a financial discussion at the recent Rio de Janiro meeting of the International Iron and Steel Institute (IISI).

It was brought out at IISI that Mexico's borrowing binge was typical. Brazil's external debt rose to $100 billion. The whole developing world went into hock for $1,000 billion. A major portion of this – 60 pct for Mexico – was owed to commercial banks. Although the money was intended for long term projects, it was lent on a short term basis at floating interest rates.

Having provided the funds for a massive steel expansion, the bankers then pulled the plug by jacking up interest rates. The U.S. prime rate went over 20 pct in late 1980 and stayed high through most of the next two years.

One effect was to depress world markets. In 1982, steel shipments of U.S. producers fell to 62 million tons, the lowest level since 1958.

Also depressed were the economies of developing countries. With home demand lagging, steel producers in Brazil and elsewhere stepped up export efforts.

"For private enterprise, which must produce profits, there is no alternative but to export," said Jorge Gerdau Johannpeter, head of Brazil's Gerdau Group and also president of the country's Association of Private Steelmakers.

For both public and private companies, the pressure to export was compounded by the huge foreign debts. Brazil's interest payments rose to $10 billion a year or more than 3 pct of GNP. The debts created pressure and they also provided leverage for gaining access to foreign markets.

"It is important to stress to the countries whose debtors we are, that the possibility of our settling our external debt is being restricted by their imposing obstacles to their importation of our steel products," said Mr. Johannpeter.

Among those sympathetic to this view are the bankers. "All the big American banks except one have more credit in the developing countries than their assets," said Wolfran Engels, professor at Johann Wolfgang Goethe University.

The banks would all go broke if developing countries defaulted, said Dr. Engels. (The one exception would go down because it has lent money to the other banks, he said.)

One final bit of mischief was wrought by the banking community. By keeping U.S. interest rates high, the bankers drew funds into the country and strengthened the dollar. This made the U.S. a particularly inviting target for surplus steel.

As a result of all this, a large amount of steel was forced on a weak world market. Needless to say, the prime recipient was the U.S. Imports from developing countries to the U.S. rose from 3.2 million tons in 1980 to more than

'Even under peak demand conditions, a large part of capacity ... will remain idle in (1990).'

Lenhard J. Holschuh, secretary general of IISI.

The developing countries 'have become the dominant influence in the American steel market.'

David M. Roderick, chairman of USX Corp.

6.3 million tons in 1983.

The developing countries "have become the dominant influence in the American steel market," said David M. Roderick, chairman of USX Corp. and head of AISI at that time.

In 1984, there was a further increase to 10 million tons of U.S. imports from developing nations. This lifted total imports to more than 26 million tons. Another 24 million tons arrived in 1985. The two-year intake of 50 million tons had a devastating effect on the American steel industry.

Steel imports are now receding a little. Brazil, Korea, and other developing countries have been brought into the U.S. voluntary restraint program for steel. In addition, there have been economic revivals in Brazil, Venezuela, and Argentina. The Brazilians are, in fact, having second thoughts about the export of semifinished steel to the U.S.

The export surge is easing, but the developing countries are moving ahead with fresh expansion programs. Steel capacity of the developing world is expected to increase from 86 million tons in 1985 to 110 million tons in 1990.

The added capacity should be needed to meet home needs. Brazil's steel usage of 93 kg per capita is well below the average of advanced nations. With general industrial growth, steel consumption in developing countries is scheduled to rise from 101 million tons in 1985 to 119 million tons in 1990. The developing bloc will still be a net importer of steel by the end of the decade.

The developing countries continue to rely on external financing for industrialization. In fiscal 1986, the World Bank lent $1.2 billion to Brazil and $1.7 billion to India. There is a major precedent for these transaction.

"In the 18th and 19th centuries," said Dr. Engels, "the U.S. was a developing country with a supposedly high current account deficit for more than 100 years."

That may be true, but with the mobility of both capital and technology today, instant industrialization can cause excesses. In planning their expansions, the developing nations must keep in mind that the world steel market can't absorb large surpluses.

According to IISI, the industrial nations now have about 450 million tons of steel capacity and only

LATIN AMERICAN STEEL PROFILES

The Latin American steel industries were spotlighted by October meetings of the International Iron & Steel Institute (IISI) in Brazil and of the Latin American Iron and Steel Institute (ILAFA) in Mexico.

The status of steel in the various countries was covered in presentations at IISI and in the ILAFA publication, Siderurgica Latino.

About 37 million tons of raw steel will be produced by Latin American countries in 1986. This tonnage, which will be double the output of 10 years ago, comes from 30 fully integrated mills and 67 semi-integrated plants.

In 1985, oxygen furnaces accounted for 56 pct of Latin America's steel and electric furnaces 37 pct. More than 18 pct of the iron production was by direct reduction and 6.6 million tons of iron came from charcoal blast furnaces.

Brazil

About 68 pct of Brazil's steel comes from nine integrated mills controlled by SIDERBRAS, the state holding company.

Amaro Lanari, president and chairman, SIDERBRAS: "From a modest 19th place in 1970, we jumped last year, with a record 20.5 million tons, to 7th place among the major steel producing countries in the Western World.

"However, if we consider per capita steel consumption, in 1985 our index was 93 kg per capita, lower than that of countries with the same degree of development... the country must increase its steel production.

"Thus we dare to state that up to the end of the next decade, we must double our production to reach a figure of around 40 million tons per year.

"We do not believe in the immediate need to install large sized works starting from zero (greenfield).... Thus our new investments will be in accordance with our capital and indebtedness capacity...." Source: ILAFA

Private Sector

Of the 20.5 million tons produced by Brazil in 1985, 6.4 million tons came from the private sector.

Jorge Gerdau Johannpeter, president of the Association of Private Steelmakers and also head of the Gerdau Group: "The private sector, responsible for more than 83 pct of non-flat steel pro-

'For the steel industry, this overall state of the economy means that severe difficulties lie ahead.'

Yashuhiro Yagi, president of Kawasaki Steel Corp.

'The fact that large subsidies are still being paid out in most EEC countries remains unsatisfactory.'

Wilhelm Scheider, chairman of Fried Krupp GmBH

321 million tons of steel consumption. The big nations have been working to reduce the surplus. Since the start of 1977, raw steel capacity has been reduced by 33 million tons in the U.S., 35 million tons in Europe, and 13 million tons in Japan.

There will be more cutbacks, but with consumption declining in the industrial nations, the world will continue to have a lot more steel than it needs.

"We expect a Western World crude steelmaking capacity of about 550 million tons for 1990," said Lenhard J. Holschuh, secretary general of IISI. "It is evident that even under peak demand conditions, a large part of capacity, which can be estimated at 70 million tons, will still remain idle in that year."

Overcapacity has been producing price cutting and profitless operation. Steel prices fell 9 or 10 pct in the U.S. last year. There was a similar problem in Europe.

"The price situation in the German steel industry remains unsatisfactory owing to stiff international competition," said Wilhelm Scheider, chairman of Fried Krupp GmBH.

Yen vs. Dollar

For Japan's steel producers, depressed world prices were especially painful because the yen has appreciated more than 50 pct against the dollar. In the first eight months of 1986, the 66 million tons of raw steel produced in Japan was down 7 pct from 1985.

"The outlook for the new fiscal year is grim enough," said Yashuhiro Yagi, president of Kawasaki Steel Corp. Both export and domestic activity will lag while the yen remains strong, said Mr. Yagi.

"For the steel industry," he said, "this overall state of the economy means that severe difficulties lie ahead. Decline in domestic sales would be inevitable because a portion of these sales translates into exports of steel in processed form, such as autos, machine tools and home appliances."

In this economic climate, many of the industrial nations are moving to restrict steel imports. The European Common Market has long regulated external steel trade through bilateral agreements.

American producers charged that the European restraints di-

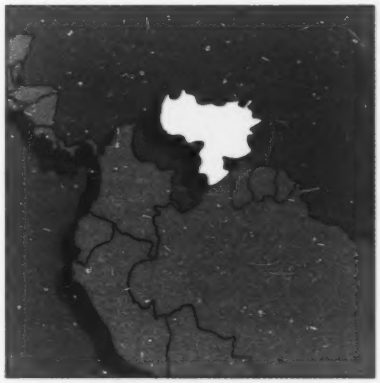
duction, is at present composed of 27 companies of which seven are integrated mills and 20 semi-integrated. (Products include) reinforcing bars, profiles, merchant bars, seamless pipes, wire rods, and wires.

"From only 2.4 million tons in 1971, production reached 6.5 million tons in 1985. In that year, private mills exported 1.9 million tons, representing about 30 pct of total steel production.

"Up to the end of the 1970s, exports represented an insignificant percentage of the sector's sales. From 1981, however, the non-flat steel sector, as also the whole steel sector, began to undergo problems in consequence of the country's slower pace of industrial activity.

"The economic crisis... left only two options: To operate the steel mills at a high rate of idle capacity and increasing losses; or to attempt to export the excess not absorbed by the domestic market.... For private enterprise..., which must produce profits, there is no alternative but to export.

"It is important to stress to the countries whose debtors we are and who often impose on us protectionist and discriminatory measures, that the possibility of our settling our external debt is being restricted by their imposing obstacles to their importation of our steel products." Source: IISI



Venezuela

Venezuela produced 3 million tons of steel in 1985, exporting 1.5 million tons of this total.

The biggest producer is the state-owned SIDOR, which makes extensive use of direct reduction.

Cesar A. Mendoza, president of SIDOR and also chairman of ILAFA: "For 1986, the company will be able to show a positive balance sheet for the first time in many years. The new situation makes it possible for the company to reach financial autonomy and put into effect the necessary investment programs for process improvements, cost reduction, product improvement and new product development.

"SIDOR will reach 3 million tons of crude steel in 1986, production volume to be increased to 4 million tons by 1990. We expect to enlarge our share on international markets to one and a half million tons of steel products.

"Apart from SIDOR's operational investments, FERROMINERE is planning a new pelletizing plant and new facilities for sponge iron to cover the requirements of our own steel industry and also for export. The private sector also has plans for modernizing and capacity expansion." Source: ILAFA

(Midrex Corp. has contracted with MINORCA to supply technology for the reactivation of a 720,000-ton reduction plant.) (Cont. on p. 34.)

(Mill)

	Metric tons, millions		Pct. change
	1985	1986*	1986 vs. 1985
	433	425	-1.8
	211	215	+1.9
	79	81	+2.5
	723	721	-0.3

*Estimated

verted steel to the U.S. Now, the U.S. has its own import quotas, and Canadians say these are diverting steel to Canada.

Imports accounted for 19 pct of Canada's steel supply in 1985. The Canadians say more than half the foreign tonnage was dumped or subsidized. In dealing with the problem, Canada is in the difficult position of resisting quotas on its shipments to the U.S. while moving toward controls for its own imports. (The big Canadian steel companies are informally restricting exports to the U.S.)

"All we've asked for is a monitoring process," insisted Don Belch, senior trade relations manager for Stelco Inc. "Import permits will be freely issued to anyone who asks for them."

The fact is that trade restraints by one country tend to force restraints by others. It's worth noting that while Brazil was complaining about U.S. steel quotas, the U.S. was complaining about Brazilian restrictions on computer imports.

Protectionism

There is a world trend toward protectionism, and there is extra bias against steel surpluses based on government subsidy. Much of the developing world's steel is government owned.

Free trade should be encouraged, said Jan D. Hooglandt, chairman of Hoogovens and retiring IISI chairman. But, he added, "the situation is different, of course, if we have to deal with centrally planned economies where cost has ceased to be a meaningful factor. In such cases, retaliatory measures – preferably of a temporary nature – by other countries may be justified."

Government support wasn't confined to developing countries

Argentina

Carlos A. Magliano, president and chairman, SOMISA: "SOMISA's policy aims at maximum use of its capacity in order to reduce costs, contribute to the health of the economy's external sector and maintain the level of employment.

"Steel consumption in Argentina dropped to its lowest level in years in 1985, but SOMISA increased raw steel production, lit its blast furnace No. 2, and practically kept back the import of semifinished products.

"The production not sold domestically was exported.... For example, total exports of the first five months of 1986 reached 350,000 tons (Out of 720,000 tons shipped over all.)

The domestic economy has recovered, "but in spite of the growing domestic demand, it is SOMISA's purpose to stay in the export market.

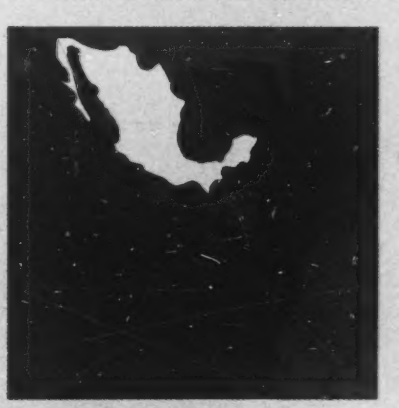
"Plans have been approved to surpass the 2 million ton level of raw steel production during the next months." Source: ILAFA

Private Sector

Alsides Lopes Aufrank, president and chairman, ACINDAR: "As Argentina's largest private steel enterprise, ACINDAR ranks also among the major steel companies in Latin America with manufacturing facilities that have potential production capacity of over 1.5 million tons of raw steel a year."

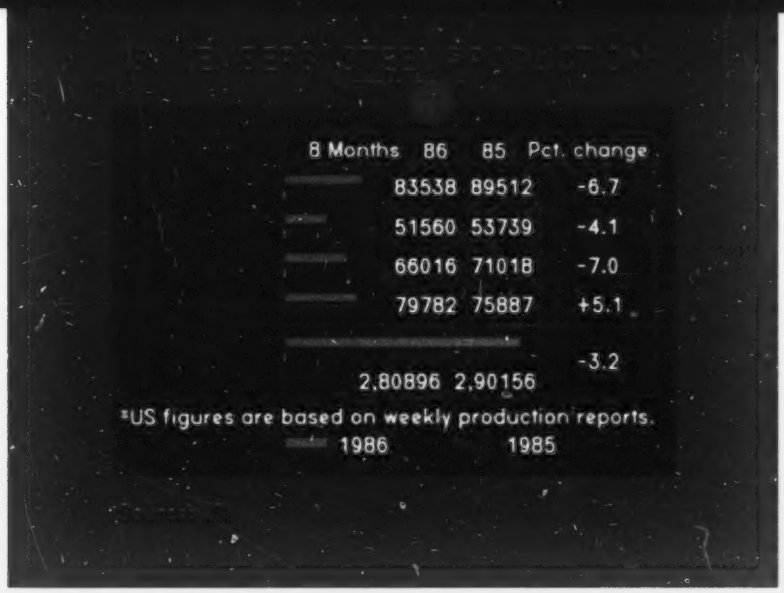
ACINDAR exported more than 370,000 tons in 1985, but is unhappy about protective measures.

"The United States, the nations that form the European Economic Community and even Canada have been blocking the access to a large number of Argentinian products.... The EEC applies protectionist criteria the same as the U.S. through the arbitrary or subjective setting of trigger prices. And Canada promoted in 1985 anti-dumping actions against Argentinian exports of barbed wire and seamless tubes." Source: ILAFA



Mexico

With raw steel output of 7.2 million tons in 1985, Mexico was the second largest producer in Latin America. Grupa In-



in 1985. "For the German steel industry, the fact that large subsidies were still being paid out in most EEC countries remained unsatisfactory," said Mr. Scheider of Krupp. However, government involvement is extensive in the developing world.

In Brazil, a loss of $200 million a month is being recorded by SIDERBRAS, the state holding company which controls 68 pct of the country's steel. The company will need a direct government subsidy of $700 million to get through the year. Nevertheless, Brazil is planning to expand steel capacity from 20 million tons now to 40 million tons by the year 2000.

In Australia, BHP is spending heavily on steel. "This investment, which will continue at more than $1 million a day, will total $1.4 billion for the duration of the Steel Plan," said David Rice, chief executive of BHP Steel International Group.

BHP doesn't rely on the Australian government for capital; the steel group earned $254 million last year; but BHP did receive a government 'bounty' of $11 million.

In Korea, the new Kwangyang Works is being brought on stream by the state-owned Pohang Iron & Steel Co. In Taiwan, the government-owned China Steel Corp. is in the middle of a $1.4-billion expansion.

A 3 million-ton greenfield plant is reportedly planned for Ningbo in mainland China. Great Britain and China have signed letters of intent for the project, which will cost $4 billion and be based on foreign financing.

It can possibly be argued that international credit is more likely to produce unbalanced growth than government involvement. Prior to the 1960s, do-it-yourself policies enabled Brazil to grow without the need to earn foreign credits.

"Real GNP expanded at average annual rates of 5.6 pct between 1926 and 1964, with industrial output growing 7.8 pct a year," said Mario Henrique Simonsen, former minister of planning for Brazil. "Industrial expansion was then mostly financed by domestic savings, reinvested profits, agricultural profits, and taxes."

To the extent that domestic savings are based on domestic wages, this kind of expansion tends to balance production with domestic buying power. "Real exports and imports virtually stagnated," said Mr. Simonsen of the Brazilian experience.

After 1964, Brazil turned away from self sufficiency, increasing its trade and its capital intake. There was rapid growth until the oil shock of 1974 left the country with a $4.7 billion trade deficit. Since 1975, Brazil has increased its exports 59 pct, reduced imports 48 pct and generated a trade surplus. □

dustrial Alfa, S.A. is a private company which operates steel plants (HYLSA) and supplies direct reduction technology (HyL).

Rafael R. Paez, chief executive officer, Grupo Industrial Alfa, S. A.: "Mexico's foreign debt grew from $34 billion dollars in 1978 to $88 billion in 1982. There was a significant increase in the proportion of commercial bank funds—around 20 pct of total financing in the 1960s to almost 60 pct in 1981. A large portion of this financing was contracted at floating interest rates. And it consisted mainly of short term credit."

External financing produced annual growth of 8.5 pct from 1978 through 1981. "However, this explosive growth turned out to be ephemeral. An adverse international environment, as evidenced by high interest rates and declining oil prices, coupled with negative domestic conditions, virtually paralyzed the economy since 1982.

"Given this environment, Mexico's challenge is to refocus its industrial development toward the export market to generate the foreign currency needed to service its enormous foreign debt.

"The problem that arises here is that quotas are imposed by country and not just to those companies getting subsidies.

"(Saddled with big debts) the profitability of the steel industry has been additionally affected by the government's restrictive policy on price controls. Last year Mexico's inflation rate was 64 pct whereas the authorized steel price increase was only 37 pct....

"Our domestic prices are 15 to 30 pct lower than the corresponding domestic prices in those countries (U.S. and Japan). Dumping prices have provided an erroneous reference point to our government in determining appropriate price increases."

Mexico's problems are particularly disheartening because the country seemed on its way to becoming a major steel power. In the early 1980s, plans called for increasing steel capacity from 8 million tons at that time to 29 million tons by 1990. The country was unique among the developing nations in that it was creating and exporting new steel technology. The HyL direct reduction process has been widely used throughout the world as well as in Mexico.

Source: IISI